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IN THE

Supreme Court of the United States

THE WHARF (HOLDINGS) LIMITED, a Hong Kong company; WHARF COMMUNICATIONS INVESTMENTS LIMITED, a Hong Kong company; and STEPHEN NG, a Hong Kong citizen,

Petitioners,

v.

UNITED INTERNATIONAL HOLDINGS, INC., a Delaware corporation; and UIH ASIA INVESTMENT CO., a Colorado general partnership,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF FOR PETITIONERS

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CORPORATE DISCLOSURE STATEMENT IN ACCORDANCE WITH RULE 29.6 OF THE RULES OF THE SUPREME COURT OF THE UNITED STATES

The corporate disclosure statement at p. ii of Brief for Petitioners dated December 21, 2000 is still accurate.

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INTRODUCTION

UIH concedes that its sole claim is that Wharf orally agreed to grant UIH an option to purchase 10% of the stock of Wharf Cable and did not intend to sell that stock to UIH.

That claim does not state a violation of Section 10(b) of the Securities and Exchange Act of 1934 ("Section 10(b)"), 15 U.S.C. § 78j(b), because the purpose of that Act was to promote the full and fair disclosure of information affecting the investment value of securities traded on United States securities exchanges, not to federalize the adjudication of disputes over the ownership of securities.

UIH's concession makes it plain that this case has nothing to do with the normal run of federal securities law litigation. There is no claim of misrepresentation affecting the issuance of new securities or the trading of securities on a national securities exchange. There is no claim that the price of a publicly traded security has been manipulated. There is no claim of nondisclosure by insiders while trading securities. UIH's alleged oral option is not one of a series of similar options, such as are traded on the Chicago Board of Options Exchange.

All we have is a dispute over the ownership of securities arising from an unsuccessful proposed private collaboration between sophisticated businesses in Hong Kong. It is little wonder that the federal courts have consistently rejected the expansive readings of Section 10(b) which would sweep into the federal courts disputes over the ownership of securities which have historically been resolved as matters of state law in the state courts and in Exchange-sponsored arbitral systems.

Every court of appeals to have faced the issue since this Court's decisions in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), and *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), has decided that the private right of action judicially implied under Section 10(b) does not extend to misrepresentations of a party's intention to sell securities. Numerous district court cases have followed those precedents and decided that the private right of action implied under Section 10(b) should be confined to disputes alleging

misrepresentations related to the value of securities. There is no justification at this late date for expanding the private cause of action judicially implied under Section 10(b) to govern disputes over the ownership of securities which have been traditionally governed by state law.

This Court's decision in *Blue Chip Stamps* provides an additional and equally important reason to reverse the decision below. The animating policy concern which drove that decision was the need to preclude dubious claims asserted by plaintiffs who seek to satisfy the purchase requirement of Section 10(b) with self-serving oral assertions. The very same policy concerns mandate dismissal of UIH's claim.

UIH did not purchase the common stock of Wharf Cable. The event which UIH seeks to characterize as the purchase of a security is wholly oral — a conversation on October 8, 1992, during which UIH claims it was orally offered, and orally "purchased", an option. UIH's alleged oral option is uncorroborated by any documentary evidence. The alleged oral option agreement of October 8, 1992 was never embodied in a writing or even referred to in any document.

UIH's attempt to distinguish *Blue Chip Stamps* ignores the fact that the plaintiffs in that case also held options. They were not members of the general investing public with no prior relationship to the selling defendants. The *Blue Chip* plaintiffs were retailers who had legal rights under a written consent decree to purchase the securities offered by the selling defendants in proportion to their past usage of certain trading stamps. UIH's claims are both more purely oral and more speculative than the dubious claims rejected in *Blue Chip Stamps*.

This Court should reverse the decision of the Court of Appeals and remand this case with instruction to vacate all judgments below. If Wharf is correct in its analysis of Section 10(b), the District Court should have dismissed the federal claims at the outset and dismissed the state-law claims under *United Mine Workers v. Gibbs*, 383 U.S. 715 (1966), because the court lacked original jurisdiction. The mistaken expenditure of judicial resources resulting from the District

Court's error does not justify an invasion of state court competence over state law decisions. In this case, vacatur of the state law judgments is also justified by the lower courts' decisions of state law which are clearly wrong and fatally infect each of UIH's claims.

ARGUMENT

I. SECTION 10(b) AND S.E.C. RULE 10b-5 DO NOT APPLY TO MISREPRESENTATIONS OF A PARTY'S INTENTION TO SELL SECURITIES.

Wharf's opening brief demonstrated that the United States Courts of Appeals have consistently refused to extend the private right of action judicially implied under Section 10(b) to govern disputes over the ownership of securities. The courts have concluded that the purpose of the Securities and Exchange Act of 1934 to promote the full and fair disclosure of information related to the investment value of corporate securities does not justify federalizing the law applicable to claims that a party has misrepresented its intention to sell securities which have until now been governed by state law. (Wharf Br. 22-32.)

A. Circuit and district courts have consistently refused to apply the right of action judicially implied under Section 10(b) where it would not serve the congressional purpose of promoting full and fair disclosure of information relating to the investment value of securities.

In support of its argument, Wharf discussed four cases from the Third, Fourth, Seventh and Ninth Circuits, all of which have held that Section 10(b) does not apply to claims that a party has misrepresented its intention to sell securities. *See Tully v. Mott Supermarkets, Inc.*, 540 F.2d 187 (3d Cir. 1976); *Hunt v. Robinson*, 852 F.2d 786 (4th Cir. 1988); *Stanford v. Humphrey*, 1990 WL 4659 (9th Cir. Jan. 25, 1990) (unpub.); *Gurwara v. Lyphomed, Inc.*, 937 F.2d 380 (7th Cir. 1991). The Third, Fourth and Seventh Circuits have reaffirmed the results in those cases in more recent precedents. *See Angelastro v. Prudential-Bache Sec., Inc.*, 764 F.2d 939, 943 (3d Cir. 1985); *S.E.C. v. Jakubowski*, 150 F.3d 675, 679

(7th Cir. 1998); *S.E.C. v. Zandford*, — F.3d —, 2001 WL 65625, *3 (4th Cir. 2001).

Numerous district court decisions have followed these circuit court precedents and dismissed cases which sought to expand the right of action implied under Section 10(b) to disputes which do not invoke to the congressional purpose of promoting full and fair disclosure of facts affecting the investment value of securities. In dismissing one such case, the United States District Court for the Southern District of New York recently described the prevailing view of the law in the following terms:

> "Numerous decisions in this district have applied *Chemical Bank* [*v. Arthur Andersen & Co.*, 726 F.2d 930 (2d Cir. 1984)] to dismiss securities fraud claims when the alleged misrepresentations did not pertain to the 'fundamental nature' of the securities: 'namely, characteristics and attributes that would induce an investor to buy or sell the particular [securities].' . . . The 'in connection with' requirement, as construed by the Second Circuit in *Chemical Bank*, has been applied in cases in which defendants were alleged to have misrepresented their intent to transfer securities to the plaintiff." *Production Res. Group, L.L.C. v. Stonebridge Partners Equity Fund, L.P.*, 6 F. Supp. 2d 236, 239 (S.D.N.Y. 1998) (citing *Gurwara*, 937 F.2d at 383; other citations omitted).

Numerous district courts have reached the same conclusion. *See, e.g., Manela v. Garantia Banking Ltd.*, 5 F. Supp. 2d 165, 175 (S.D.N.Y. 1998) ("Here, plaintiffs indeed may have been deceived as to the identity of the seller . . . but this deception had nothing to do with the value of the bonds themselves."); *Alex. Brown & Sons, Inc. v. Marine Midland Banks, Inc.*, 1997 WL 97837, *5 (S.D.N.Y. March 6, 1997) (unpub.) ("Marine's alleged misrepresentations . . . here were not made 'in connection with' the purchase and sale of the securities . . . because they do not relate to the fundamental investment attributes of the securities."); *Bissell v. Merrill Lynch & Co., Inc.*, 937 F. Supp. 237, 242 (S.D.N.Y. 1996)

("The law of this Circuit is clear that unless the alleged fraud concerns the value of the securities bought or sold, or the consideration received in return, such fraud is not 'in connection with' the purchase or sale of a security within the meaning of Rule 10b-5."); *Chase Manhattan Bank, N.A. v. Fidata Corp.*, 700 F. Supp. 1252, 1260 (S.D.N.Y. 1988) ("The federal securities laws establish a regulatory regime designed to insure full disclosure of material facts underlying the value of stock or a securities offering. The Exchange Act does not provide a supplement to essentially state-law causes of action regarding the purchase or sale of particular shares."); *Kamberos v. Gallas*, 1997 WL 119952 *3 (N.D. Ill. March 14, 1997) (unpub.) ("*Gurwara* is clearly controlling here. Kamberos has made no allegation that the defendants misrepresented the value of the Galnar stock . . . . They simply breached the agreement to give the stock to him."); *Zemans v. Karris*, 1989 WL 13161, *1 (N.D. Ill. Feb. 16, 1989) (unpub.) ("[P]laintiffs merely claim that Karris misled them by failing to indicate his intention to refuse to buy their shares. This claim plainly falls well outside the scope of the anti-fraud provisions of the securities laws.").[1]

Disputes over a party's alleged entitlement to purchase securities in the context of broker/investor relations are routinely resolved as matters of state law under the U.C.C. The bulk of these recurrent disputes are resolved within Exchange-sponsored arbitration systems, not as Section 10(b) cases in the federal courts. The resolution of these disputes has generated a substantial body of rules governing the order, purchase, settlement and delivery of securities designed to promote certainty in the purchase of securities. UIH's proposed expansion of the right of action judicially implied under Section 10(b) threatens to disrupt this existing system and transfer these disputes to the federal courts.

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[1] *See also Saxe v. E. F. Hutton & Co. Inc.*, 789 F.2d 105, 108 (2d Cir. 1986); *Ernst & Co. v. Marine Midland Bank, N.A.*, 920 F. Supp. 58, 61 (S.D.N.Y. 1996); *Abrash v. Fox*, 805 F.Supp. 206, 208 (S.D.N.Y. 1992); *Manufacturers Hanover Trust Co. v. Smith Barney, Harris Upham & Co., Inc.*, 770 F. Supp. 176, 180-81 (S.D.N.Y. 1991).

Both UIH and the S.E.C. have chosen denial as their argument of choice. Neither brief addresses the central issue raised in this appeal: whether this Court should expand the private cause of action judicially implied under Section 10(b) to govern disputes over the ownership of securities in the face of a consistent line of decisions in the circuit courts stretching over a period of 25 years which have refused to do so.

UIH and the S.E.C. seek to escape the force of this line of cases by implausibly suggesting that the lawyers in these circuit court cases forgot to allege fraud and the courts dismissed their complaints because they pled simple breach of contract claims. (UIH Br. 28-29; S.E.C. Br. 16-17 n.6.) That is a misreading of these cases. Three of the four circuit court cases cited above expressly held that plaintiffs had failed to state a Section 10(b) violation because they had not alleged a misrepresentation going to the value of the securities:

(1) In *Gurwara*, the Seventh Circuit ruled that plaintiff failed to state a Section 10(b) violation because "the *misrepresentations did not go to the value of the stock at issue or the value of the consideration in return for it.*" 937 F.2d at 383 (emphasis supplied).

(2) In *Hunt*, the Fourth Circuit relied on the fact plaintiff "has *alleged no misrepresentation of the value of the stock*" in dismissing plaintiffs' Section 10(b) claim. 852 F.2d at 787 (emphasis supplied).

(3) In *Stanford*, the Ninth Circuit dismissed plaintiff's Section 10(b) claim because *"the alleged fraud in this case is in no way related to the value of the security*; it simply relates to the failure to transfer the security." 1990 WL 4659 at *1 (emphasis supplied).[2]

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[2] The earliest of those four cases, *Tully v. Mott Supermarkets*, was decided after *Blue Chip Stamps* and before *Santa Fe* and reached the same result by holding there had been no purchase of securities. *See Tully*, 540 F.2d at 194.

In dismissing these cases, the circuit courts relied upon this Court's statements in *Santa Fe v. Green* that:

> "a private cause of action under the antifraud provisions of the Securities Exchange Act should not be implied where it is 'unnecessary to ensure the fulfillment of Congress' purposes' . . . ."

and that:

> "the Court repeatedly has described the 'fundamental purpose' of the Act as implementing a 'philosophy of full disclosure' . . . ." 430 U.S. at 477-78 (citations omitted).

The courts of appeals have consistently concluded that the philosophy of full disclosure does not support the application of Section 10(b) to disputes over the ownership of securities:

> "That goal is not furthered by bringing within the ambit of § 10(b) claims amounting to breach of contract or common law fraud which have long been the staples of state law." *Hunt*, 852 F.2d at 787-88.

The argument by UIH and the S.E.C. that these are all breach of contract cases simply fails to deal with what these cases actually say.

UIH's argument that it did allege a misrepresentation of value because Wharf's refusal to permit exercise of the alleged option reduced its value to zero is a *non sequitur*. Terrorists who bomb the Wharf Cable system may reduce the value of an option to buy its shares, but they are not Section 10(b) violators. The Seventh Circuit rejected that argument in *Gurwara*, 937 F.2d at 382-83.

B. UIH and the S.E.C. have cited no post-*Santa Fe* case that applies Section 10(b) to misrepresentations of a party's intention to sell securities.

UIH and the S.E.C. are unable to cite a single case decided after this Court's decision in *Santa Fe* in which this Court or any court of appeals has held that Section 10(b) applies to misrepresentation of a party's intention to sell securities. (UIH Br. 36-39; S.E.C. Br. 14-16.) The case principally relied upon

by the S.E.C., *United States v. Naftalin*, 441 U.S. 768 (1979), addressed two issues: (1) whether Section 17(a) of the Securities Act of 1933 applied to frauds perpetrated on brokers (as opposed to investors); and (2) whether Section 17(a) was limited to new issues. (S.E.C. Br. 14-15.) There is nothing in that case to suggest that this Court considered the issue presented here. Indeed, *Naftalin* did not even involve the private right of action judicially implied under Section 10(b).

The case next relied upon by the S.E.C., *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971), is irrelevant. (S.E.C. Br. 15.) *Bankers Life* involved misrepresentations made to the seller of securities incident to the conversion of the proceeds of a stock sale. Justice Douglas' opinion is largely devoted to rejecting defendant's arguments that Section 10(b) is inapplicable because the defrauded seller, an insurance company, was not an "investor" and because the sale did not take place on a securities exchange — both of which are irrelevant to the issue in this case. The facts of *Bankers Life* involved misrepresentations relating to value on the sell-side, as opposed to the more commonly encountered buy-side misrepresentations. On the buy-side, the misrepresentation of value relates to the value of the security; on the sell-side, it often relates to the value of the consideration received.

The circuit court cases cited by Justice Douglas and relied upon by the S.E.C. were both decided before this Court's opinions in *Blue Chip Stamps* and *Santa Fe* and, like Justice Douglas' rather tactile metaphor ("deceptive practices touching the sale of securities"),[3] are of no continuing precedential

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[3] As Judge Friendly observed:

"The difficulty [of construing Section 10(b)] has been somewhat increased by Justice Douglas' reference, in the Supreme Court's first brush with Rule 10b-5, to the plaintiff's having 'suffered an injury as a result of deceptive practices *touching* its sale of securities' . . . . We are inclined to agree with Professor Loss, that 'there is no reason to believe that the Justice's use of "touching" was anything more than his variation of "in connection with" as a matter of literary style.'" *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 942 (2d Cir. 1984) (citations omitted; emphasis in original).

value. Indeed, it is not clear whether *Bankers Life*, itself, survives this Court's decisions in *Sante Fe* and *Blue Chip Stamps*. See *S.E.C. v. Zandford*, *supra*, in which the Fourth Circuit rejected the S.E.C.'s attempt to apply Section 10(b) to a conversion case.[4]

This Court's decision in *United States v. O'Hagan*, 521 U.S. 642 (1997), relied upon by both UIH and the S.E.C., is similarly irrelevant. (UIH Br. 38; S.E.C. Br. 6, 17.) It has long been accepted that Section 10(b) may be violated by the nondisclosure of material information by a purchaser or seller of securities having a duty to disclose. The majority opinion in *O'Hagan* extended the duty of disclosure to certain parties who do not stand in fiduciary relation to an issuer of securities. The information which Mr. O'Hagan did not disclose when he purchased the stock of Pillsbury, *i.e.*, a planned tender for its shares at a price above market, plainly related to the value of the securities purchased.

Turning to the lower court cases cited by UIH and the S.E.C., not one of them is a post-*Santa Fe* decision holding that the right of action judicially implied under Section 10(b) applies to disputes over the ownership of securities.

Threadgill v. Black, 730 F.2d 810 (D.C. Cir. 1984), is a cryptic *per curiam* opinion reversing the district court's decision that a partially executed sale of stock is not a "purchase or sale" of a security under Section 10(b). The court did not address the question here at issue. *Threadgill* was distinguished by the Seventh Circuit in *Kagan v. Edison Brothers Stores, Inc.*, 907 F.2d 690, 691 n.* (7th Cir. 1990). *Luce v. Edelstein*, 802 F.2d 49 (2d Cir. 1986), is a garden-variety financial misrepresentation case. *Fogarty v. Security Trust Co.*, 532 F.2d 1029 (5th Cir. 1976), involved the alleged overvaluation of an asset on the books of the issuer. The court's opinion was addressed to the inappropriateness of entering summary judgment on the facts of that case. The

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[4] *See also Bochicchio v. Smith Barney, Harris Upham & Co., Inc.*, 647 F. Supp. 1426, 1430 (S.D.N.Y. 1986) ("In sum, the conversion of securities, even if it occurs from a brokerage account, does not state a claim under § 10(b).").

court did not address the question here at issue. *Madison Consultants v. FDIC*, 710 F.2d 57 (2d Cir. 1983), involved a scheme to acquire plaintiffs' pledged stock at prices below its market value. The court's opinion was limited to a holding that the plaintiff, as a pledgor of stock, had standing to assert a Section 10(b) claim, and that a particular misrepresentation was material. The court did not consider whether the nature of the misrepresentation was sufficient to support a Section 10(b) violation.

McGrath v. Zenith Radio Corp., 651 F.2d 458 (7th Cir. 1981), decided only that certain misrepresentations made to induce the sale of stock could have been reasonably relied upon and were made in connection with the plaintiff's sale of securities. *In re Phillips Petroleum Securities Litigation*, 881 F.2d 1236 (3d Cir. 1989), involved misrepresentations by a tender offeror which inflated the price of the target stock purchased by plaintiffs. *S.E.C. v. Milan Capital Group, Inc.*, 2000 WL 1682761 (S.D.N.Y. Nov. 9, 2000) (unpub.), involved misrepresentations about the nature of the securities being sold which went to the purchasers' opinion of their value. *Press v. Chemical Investment Services Corp.*, 166 F.3d 529 (2d Cir. 1999), involved misrepresentations going to the value of the consideration received upon sale of a security. *Hooper v. Mountain States Securities Corp.*, 282 F.2d 195 (5th Cir. 1960), decided only that a corporate issuer was a seller of its own securities whose sale was governed by Section 10(b). *Walling v. Beverly Enterprises*, 476 F.2d 393 (9th Cir. 1973), and *Richardson v. MacArthur*, 451 F.2d 35 (10th Cir. 1971), were both decided before this Court's opinions in *Blue Chip Stamps* and *Santa Fe* and are no longer viable.[5] Considering all of the cases cited by UIH and the S.E.C. collectively, it remains true that no case decided after this Court's decisions in *Blue Chip Stamps* and *Santa Fe* has held that a defendant's misrepresentation of its intention to sell securities to a plaintiff can constitute a violation of Section 10(b).

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[5] The remainder of the cases cited by UIH and the S.E.C. are distinguished in Wharf's initial brief at 28-32.

The S.E.C. suggests that this Court should look to state common law fraud in deciding this case. (S.E.C. Br. 26.) Any such reference militates *against* expanding Section 10(b) to reach lost profit claims based on allegedly fraudulent refusals to perform contractual obligations to sell securities. Under the developing law of most states, the economic loss doctrine would bar the assertion of a tort claim in such circumstances. As Wharf argued in its brief, the Tenth Circuit erred in this case by becoming the only circuit court to refuse to apply the economic loss doctrine to intentional torts. *See Dinsmore Instrument Co. v. Bombardier, Inc.*, 199 F.3d 318. 320 (6th Cir. 1999); *AKA Distrib. Co. v. Whirlpool Corp.*, 137 F.3d 1083, 1086-87 (8th Cir. 1998); *Cooper Power Sys., Inc. v. Union Carbide Chem. & Plastics Co., Inc.*, 123 F.3d 675, 680-82 (7th Cir. 1997); *Hoseline, Inc. v. U.S.A. Diversified Prods., Inc.*, 40 F.3d 1198, 1199-1200 (11th Cir. 1994). *See also Home Valu, Inc. v. Pep Boys*, 213 F.3d 960, 963-65 (7th Cir. 2000) (reaffirming *Cooper Power Systems*); *Marvin Lumber & Cedar Co. v. PPG Industries, Inc.*, 223 F.3d 873, 884-86 (8th Cir. 2000) (reaffirming *AKA Distributing)*.

The economic loss doctrine is an accepted part of federal law as well. *See, e.g., East River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986). The doctrine should be applied in this case to prevent the use of Section 10(b) to circumvent the application of contract law to disputes over the ownership of securities arising from alleged contracts.

Limitation on the scope of the right of action judicially implied under Section 10(b) is fully justified in this case because the philosophy of full disclosure embodied in the Securities and Exchange Act does not justify extending that implied right to the adjudication of disputes over the ownership of securities. There is no reason at this late date to expand the private right of action judicially implied under Section 10(b) to govern disputes over the ownership of securities which have been traditionally governed by state law.

II. UIH'S ATTEMPT TO SATISFY THE "PURCHASER" REQUIREMENT OF SECTION 10(b) BY CLAIMING THAT IT ORALLY PURCHASED AN ORAL OPTION IS BARRED BY THIS COURT'S DECISION IN *BLUE CHIP STAMPS*.

UIH never purchased the common stock of Wharf Cable. UIH concedes that its only claim of standing under Section 10(b) as a purchaser of securities is based on a wholly oral event — the conversation of October 8, 1992 during which UIH claims to have been orally offered, and to have orally "purchased", an option.

UIH's standing claim is inconsistent with this Court's decision in *Blue Chip Stamps*. In that case, this Court, over the S.E.C.'s objections, held that standing to assert a claim under Section 10(b) required that the plaintiff be a purchaser of securities. In doing so, the Court repeatedly stressed the dangers of accepting oral evidence in satisfaction of the threshold "purchaser" requirement. The Court noted:

> "Without the *Birnbaum* rule, an action under Rule 10b-5 will turn largely on which oral version of a series of occurrences the jury may decide to credit . . . .
>
> "The fact of purchase of stock and the fact of sale of stock are generally matters which are verifiable by documentation, and do not depend upon oral recollection, so that failure to qualify under the *Birnbaum* rule is a matter that can normally be established by the defendant either on a motion to dismiss or on a motion for summary judgment. . . .
>
> "[T]he abolition of the *Birnbaum* rule would throw open to the trier of fact many rather hazy issues of historical fact the proof of which depended almost entirely on oral testimony." *Blue Chip Stamps*, 421 U.S. at 742-43.

These concerns led this Court to adopt a standing rule for aspiring Section 10(b) plaintiffs designed to avoid the proliferation of dubious claims created by plaintiffs whose claim of purchase was based on self-serving oral assertions.

The courts of appeals have consistently interpreted this Court's *Blue Chip Stamps* decision to bar plaintiffs who seek to predicate Section 10(b) claims upon unenforceable oral agreements to purchase. *Kagan, supra*, and *Pelletier v. Stuart-James Co., Inc.*, 863 F.2d 1550 (11th Cir. 1989), are only the two post-*Blue Chip* circuit court decisions known to counsel which contain a reasoned analysis of the question here at issue: whether a plaintiff which predicates its claim of purchase on an oral event has standing to assert a Section 10(b) claim. Both the Seventh and the Eleventh Circuits decided that *Blue Chip Stamps* forecloses such Section 10(b) claims.[6]

A. UIH's oral option argument is not supported by the case law or the language of the Securities and Exchange Act of 1934.

None of the circuit court opinions cited by UIH or the S.E.C. holds that a plaintiff whose claim of "purchase" ~~is an~~ oral event has standing to assert a Section 10(b) claim. (UIH Br. 34-35; S.E.C. Br. 27.) *Threadgill, supra*, is a cryptic *per curiam* opinion involving a partially executed and documented sale of stock. As the Seventh Circuit said in *Kagan*:

> "We do not understand *Threadgill* to hold that an oral agreement that could not be enforced in any respect under § 8-319 of the UCC is nonetheless a 'sale' within the meaning of the securities laws." *Kagan*, 907 F.2d at 691 n.*.

The *Fogarty* and *Madison* cases provide no support for UIH's argument because they both involved completed, documented sales. *Fogarty*, 532 F.2d at 1031-32; *Madison Consultants*, 710 F.2d at 58-60. Neither court addressed the issue presented here. The holding in *Chariot Group, Inc. v.*

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[6] The S.E.C. purports to distinguish the *Pelletier* decision because the circuit court observed that unenforceable promises can, under certain circumstances, play a part in conduct which is actionable under Section 10(b). (S.E.C. Br. 27 n.13.) And so they can, as can a multitude of oral statements. But that is irrelevant to the issue at hand, which is whether a Section 10(b) claimant can predicate his satisfaction of the "purchaser" requirement on oral evidence. The court in *Pelletier* clearly held that the claimant could not. *Pelletier*, 863 F.2d at 1556.

American Acquisition Partners, L.P., 751 F. Supp. 1144 (S.D.N.Y. 1990), is flatly inconsistent with UIH's argument. The court in *Chariot Group* dismissed plaintiff's claim because plaintiff did not have an enforceable agreement: "Absent due execution of the Agreement . . . there was no agreement to sell securities, and hence nothing on which to predicate jurisdiction under 15 U.S.C. 78j(b)." *Chariot Group*, 751 F. Supp. at 1152.[7]

The cases relied upon by the S.E.C. to support its argument that the courts have embraced the notion of an oral security are irrelevant to the issue at hand. (S.E.C. Br. 24-25.) Neither this Court's opinion in *S.E.C. v. W. J. Howey Co.*, 328 U.S. 293 (1946), nor any of the other cases relied upon by the S.E.C. hold that the *Blue Chip Stamps* purchase requirement may be satisfied by an oral event. All of those cases dealt with documented purchases of securities.

The S.E.C.'s expansive embrace of oral securities is inconsistent with the very language of the Securities and Exchange Act. The definition of "security" in Section 3(a)(10) of the Act enumerates the following types of instruments:

> "(10) The term 'security' means any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security,

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[7] The district court's much earlier opinion in *Desser v. Ashton*, 408 F. Supp. 1174 (S.D.N.Y. 1975), which reaches a contrary result, is best understood as a manifestation of the overly exuberant judicial attitude toward the implication of rights prevalent before this Court's *Santa Fe* opinion. As put in a more recent decision:

> "[T]he logic of *Blue Chip* inexorably leads to the conclusion that a person who alleges a violation of Rule 10b-5 must demonstrate that he is either an actual purchaser/seller or that he was party to a legally enforceable contract to purchase or sell securities. The decision in *Desser* is not persuasive." *Southeastern Waste Treatment, Inc. v. Chem-Nuclear Sys., Inc.*, 506 F. Supp. 944, 953 (N.D. Ga. 1980).

> certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." 15 U.S.C. § 78c(a)(10), *amended by* Act of Dec. 21, 2000, Pub. L. No. 106-554, 114 Stat. 2763.

The common characteristic of the several elements of this definition are that they are all written instruments. Application of the *ejusdem generis* canon of construction would therefore suggest that all "securities" under the Securities and Exchange Act of 1934 must be written instruments.

The argument that oral events must be accepted as security purchases to ward off some impending wave of imaginative securities fraud about to engulf the securities exchanges is obviously not suggested by the facts of this case. Those facts reveal only an unsuccessful proposed private collaboration in Hong Kong which has absolutely no significance for the integrity of the United States securities markets. The implausibility of any such fear is revealed by the absence of reported cases in which the S.E.C.'s enforcement efforts have been frustrated by con artists so subtle as to leave no written trace of their chicanery.

B. The Court's concerns over the proliferation of dubious Section 10(b) cases based on oral claims of "purchase" mandate dismissal of UIH's complaint.

Seeking to avoid the obvious preclusive implications of *Blue Chip Stamps*, UIH seeks to distinguish itself by arguing that, unlike the plaintiffs in *Blue Chip*, UIH had an "option". (UIH Br. 25-26.) UIH's "option" is, of course, no more than

its lawyers' recharacterization of the oral conversation on October 8, 1992. We pause to note that UIH's claim that Wharf did not challenge its attempt to avoid *Blue Chip Stamps* on appeal is erroneous and unsupported by the record.[8]

The difficulty with UIH's argument by distinction is that the plaintiffs in *Blue Chip Stamps* also had an option. The plaintiffs in *Blue Chip Stamps* were not simply members of the general investing public with no preexisting relationship to the selling defendants. The plaintiffs in *Blue Chip Stamps* were retailers who had legal rights to purchase the securities in question under a consent decree which entitled retailers who had used certain trading stamps to purchase securities in proportion to their past usage of those stamps. *See Blue Chip Stamps*, 421 U.S. at 725-26.

By way of further distinction, UIH argues that, unlike the plaintiffs in *Blue Chip Stamps*, it can offer corroboration. UIH misreads the record in this case. UIH's option claim is wholly oral. There is absolutely *no* documentation corroborating the existence of that alleged oral option. The alleged oral option of October 8, 1992 was never embodied, or even referred to, in any document created after October 8, 1992.[9]

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[8] At pages 5-6 in its Reply Brief in the Court of Appeals, Wharf argued:

> "UIH's attempt to create a purchase or sale by rechristening the alleged oral option as the 'sale' of an option is foreclosed by *Kagan* and *Pelletier*. UIH's renaming of the alleged oral agreement does not alter the fact that UIH remains without an enforceable right to acquire securities."

Wharf has repeatedly claimed that UIH was not a "purchaser" of securities with standing to assert a Section 10(b) claim under *Blue Chip Stamps*. UIH's attempt to avoid the application of that decision by renaming a part of the October 8, 1992 conversation as the "purchase" of an "option" is part and parcel of that argument.

[9] As Wharf demonstrated in its initial brief, UIH's oral option claim was, in fact, inconsistent with contemporaneous drafts of letters of intent and shareholder agreements, all of which proved that the parties intended to be bound only if and when their boards of directors had approved the transaction and only if and when the parties had executed a written 50-page shareholders agreement which the parties were negotiating —

The plaintiffs in *Blue Chip Stamps* had far more by way of corroboration. They had a consent decree which gave them, in writing, an option to purchase a determinate number of shares. They had a prospectus which contained specific allegedly false statements about the financial condition of the issuer. All UIH has is the oral testimony of its highly interested officers that Wharf told them they could have an option to purchase 10% of the stock of Wharf Cable — an alleged option which UIH *never* bothered to reduce to writing.

Nor is UIH's claim any less speculative than those asserted in *Blue Chip Stamps*. UIH's claim is *not* based on historical fact; it is purely hypothetical. It is based on the *hypothesis* that UIH would have exercised its alleged option to buy stock in Wharf Cable; that it would have invested $50,000,000+ in Wharf Cable over a period of years; that Wharf would have prospered in a fashion which did not occur; and that the Hong Kong stock market would have valued the stock of Wharf Cable far more generously than it has in fact.

Given the policy concerns expressed in *Blue Chip Stamps*, why should it make any difference that the oral evidence which *Blue Chip Stamps* rejected as a sufficient predicate for standing is said to constitute the purchase of an option? The animating concern in the *Blue Chip Stamps* decision was to preclude the assertion of dubious Section 10(b) claims where a plaintiff seeks to satisfy the purchase requirement by oral evidence because of the ease with which such allegations are manufactured. As the court said in *Kagan*, "[i]t is easy to *say* that there was an oral agreement". 907 F.2d at 691 (emphasis in original). It is just as easy to say ". . . and defendant never intended to abide by the agreement". That is exactly what UIH says here.

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neither of which events ever occurred. (Wharf Br. 3-12.) Those documents also proved that the parties were negotiating a stock purchase agreement which would have obligated UIH to purchase the stock of Wharf Cable — not an option. UIH's "corroborative" evidence consists largely of sound bites from documents which evidence no more than Wharf's attempts to extricate itself from the persistent and increasingly unwelcome advances of a corporate suitor, with whom Wharf had no contract.

UIH's assertion that it sustained an economic loss does not distinguish its claim. The plaintiffs in *Blue Chip Stamps* also had a potentially legitimate claim of economic loss, which this Court acknowledged. *See* 421 U.S. at 737-38. Notwithstanding that economic interest, the Court decided that the "countervailing advantages" of precluding such dubious oral claims justified the sacrifice of whatever economic interest those claims might entail. That very same analysis mandates dismissal of UIH's claim.

III. THIS COURT SHOULD REVERSE THE COURT OF APPEALS' DECISION AND REMAND THIS CASE WITH INSTRUCTIONS TO VACATE ALL JUDGMENTS BELOW.

This case should never have been brought in federal court. It was apparent from the outset that UIH had no standing and that its complaint did not allege a Section 10(b) violation. There was nothing unusual or exceptional about Wharf's grounds for dismissal. Wharf's motion to dismiss was based on straightforward application of longstanding precedent. If the district court had properly applied the law, the court would have been required to dismiss the state law claims under *United Mine Workers v. Gibbs*, 383 U.S. 715 (1966), because it would have dismissed all claims over which it had original jurisdiction. UIH's state law claims also should have been dismissed because these claims would have "substantially predominated" and because they raised important, novel and complex issues of state law. *See* 28 U.S.C. § 1367. Under the circumstances of this case, considerations of federalism and comity required dismissal so that these issues of state law could be decided in a state court where they belong.

The only conceivable justification for preserving the state law judgments in this case, at this stage, would be preservation of a jural result obtained because of an erroneous decision by the district court. The Third and Seventh Circuits properly perceived that the consequences of judicial error cannot justify an otherwise unacceptable invasion of the proper sphere of the state courts. *See Tully*, 540 F.2d at 196; *Wellness Community-National v. Wellness House*, 70 F.3d 46, 50-51 (7th Cir. 1995).

This Court's decision in *Steel Co. v. Citizens for a Better Environment*, 523 U.S. 83 (1998), does not call for a different result, as it was addressed to the priority of constitutional and statutory considerations in delimiting the jurisdiction of the federal courts. Indeed, to the extent that the majority opinion stresses the primacy of constitutional limitations on federal courts' jurisdiction, it suggests that federal courts should show more deference to state court determination of state law out of respect for the federal structure of the Constitution.

These considerations have special force here because the Tenth Circuit was clearly wrong in its state law decisions with respect to the Colorado statute of frauds and the economic loss doctrine. *Cf. Leavitt v. Jane L.*, 518 U.S. 137, 144-45 (1996).

The Tenth Circuit was clearly wrong in holding that the economic loss doctrine under Colorado law does not apply to intentional torts, as evidenced by the fact that its decision conflicts with those of every other circuit court that has decided the question. (*See* cases cited at Wharf Br. 19.) This case is the quintessential economic loss case. UIH seeks recovery of contractual benefit-of-the- bargain damages and complains only of Wharf's "fraudulent" refusal to perform its alleged contractual obligation to sell UIH the stock of Wharf Cable. As the Colorado Supreme Court recently held: "A breach of duty which arises under the provisions of a contract between the parties must be redressed under contract, and a tort action will not lie." *Town of Alma v. Azco Constr. Inc.*, 10 P.3d 1256, 1262 (Colo. 2000) (en banc).[10]

The Tenth Circuit was also clearly wrong in ruling that § 8-319 of the U.C.C., barring the enforceability of an oral

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[10] *See also Grynberg v. Agri Tech, Inc.*, 10 P.3d 1267, 1270 (Colo. 2000) (en banc) ("This is a classic example of a case where the plaintiffs are seeking to recover damages for the loss of their bargain with defendants. These are pure economic loss damages based on disappointed expectations. An action to recover damages for the loss of a bargain is the exclusive province of contract law.") (citing *Detroit Edison Co. v. NABCO, Inc.*, 35 F.3d 236, 239 (6th Cir. 1994) ("The economic-loss doctrine is a judicially created doctrine that bars all tort remedies where the suit is between an aggrieved buyer and a nonperform[ing] seller, . . . and the only losses alleged are economic.") (citation omitted)).

"contract for the sale of securities", does not apply to this case because UIH's alleged oral option is not a "security". Under § 8-319, the alleged oral option was plainly the oral "contract" which the statute of frauds rendered unenforceable and the "security" was the common stock of Wharf Cable.

As Wharf has shown, these errors require vacatur of UIH's judgment as to all of its state law claims, including its fraud and breach of fiduciary duty claims. (Wharf Br. 16-19.) Finally, and most egregiously, the Tenth Circuit was clearly wrong in failing to give critical scrutiny to UIH's undeniable misrepresentation of its damages, which resulted in an undeniable $100,000,000 error below. (Wharf Br. 13-14, 19-21.)

CONCLUSION

For the reasons stated, Wharf respectfully requests that this Court reverse the decision of the Court of Appeals and remand this case with instructions to vacate all judgments entered below.

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